Axia annual report 2006

...and now we landed in a country that shares our beliefs; real broadband open access networks are the engine of the 21st century economy!

France is among the most advanced countries in Europe in the use and development of telecommunications services. It is also Europe's third largest telecom market, with a population recognized for its adoption of emerging technologies.

The Government of France believes that ubiquitous, Real Broadband (RB) access is a critical national infrastructure. It has committed to spend €3 billion on this initiative and has implemented a policy framework that supports building open and competitive Internet Protocol (IP) networks. France's commitment is to provide affordable RB access to everyone, including those who reside in traditionally underserved areas.

This is an ideal business environment for Axia to succeed. Our open access approach and the combined expertise of our partnership has enabled the Axia-VINCI joint venture to emerge as a leader in the French marketplace.

that's where some of France's networking was done in the past, until Axia and its partners were chosen to build regional real broadband networks for the future

The national government's strategy is to allow decisions on who will create and operate its Real Broadband networks to be made at the local level through Delegations de Service Public (DSP) mechanisms.

Axia, along with its 50/50 joint venture partner VINCI Networks, is pursuing DSP opportunities throughout France. Axia-VINCI has already been awarded 10 concessions and is currently pursuing an additional 30 network concession opportunities, with additional bidding prospects expected in the future.

For each project, VINCI Networks will provide the construction, project management, infrastructure and knowledge of the France marketplace to the joint venture. Leveraging its experience as the designer and operator of the Alberta SuperNet, Axia will provide network design equipment selection and equipment installation, operation and sales of IP services expertise to the joint venture.

Axia-VINCI will enable and support local access operators and Internet service providers as they deliver their IP services to government, business and retail customers. Based solely on the projects it has been awarded to date, the Axia-VINCI joint venture has won 10 concessions reaching more than 1,500 communities with a population of three million people and 100,000+ businesses of all sizes.

France
60 million people
547,000 km²

Axia-VINCI's current 10 concessions reach
3 million people
1,500 communities
100,000 businesses

Alberta's government had the vision to make global connectivity available to all citizens

Thanks to the Alberta SuperNet, Albertans now have the choice to access affordable Real Broadband services across the province from the world's best IP, ubiquitous, ultra-high-speed broadband network.

The Alberta SuperNet connects 429 communities and provides direct connectivity to 4,400 government, learning, health, library and municipal locations.

The Alberta SuperNet uses Axia's open access model which allows market forces to develop a competitive environment for service providers to deliver any kind of Internet access services, from lower cost best-effort services to ultra-high-performance services, to their retail and business customers. Any service provider can buy basic IP services and bandwidth services directly from Axia on a level playing field basis. Currently, 180 communities have access to high-speed connectivity from 74 service providers who connect to the Alberta SuperNet. Prior to the Alberta SuperNet, Alberta's rural communities only had dial-up access and any hope of Real Broadband IP connectivity was either cost prohibitive or technically out of reach.

Alberta
3.3 million people
662,000 km²

the Alberta SuperNet connects

429 communities
221 municipalities
2,073 learning facilities
309 library facilities
421 health facilities
1,335 government offices

optical / wireless network

13,000 km in total length
10,900 km fibre connectivity
2,100 km wireless connectivity

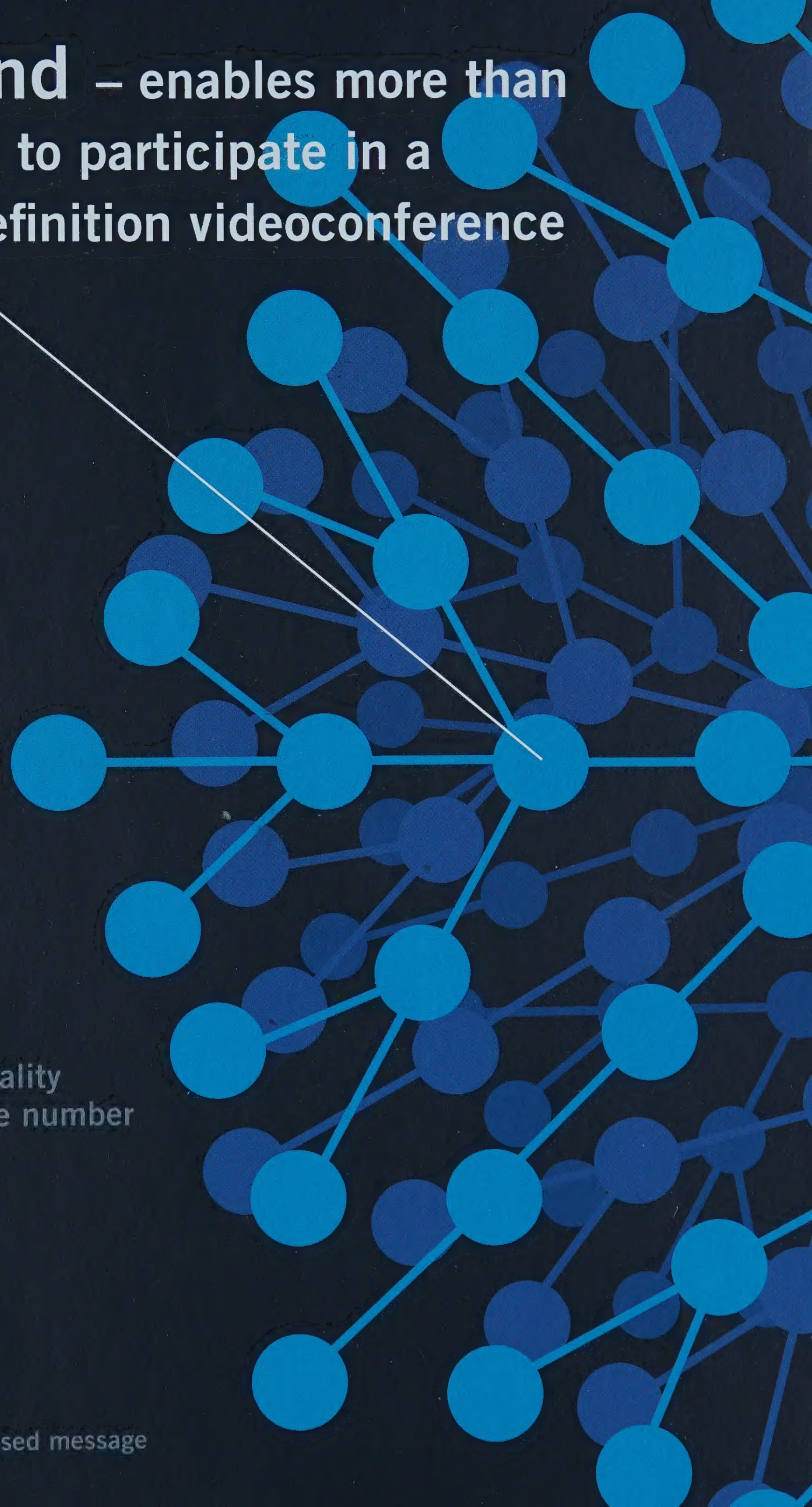
Axia creates ultra-high-performance real broadband networks that operate in gigabits and beyond

Just as transportation opened up new economic horizons in the last century, Real Broadband will pave the way for productivity gains across global economies in the new century. New applications that depend on Real Broadband have eclipsed the capacity limits of traditional, copper legacy networks. Governments, organizations and individuals are recognizing the limitations of legacy network technologies and are switching to next-generation, limitless IP networks. Today many people consider 1.5 Mbps or 3.5 Mbps best-effort Internet connections to be "high-speed", but they are not fast or reliable enough to drive the new knowledge-based economy.

Real Broadband IP networks provide users with bi-directional, real-time uncompromised performance 24/7. Studies have estimated that access to Real Broadband (>10Mbps) could increase US GDP by up to US$500 billion for the next 10 years. Australia has reported that next-generation broadband could produce economic benefits of US$12-30 billion per year. Axia is solving the challenge of digital connectivity to corporations, governments and citizens by bringing connectivity and the global IP gateway to their doorsteps.

Axia's Real Broadband networks provide guaranteed ultra-high-performance, bi-directional communications for voice, video and data over a single network. Axia is helping to achieve the vision of unlimited, unrestricted data exchange that is independent of geography.

Real Broadband – enables more than **1,000 people** to participate in a multipoint, High Definition videoconference



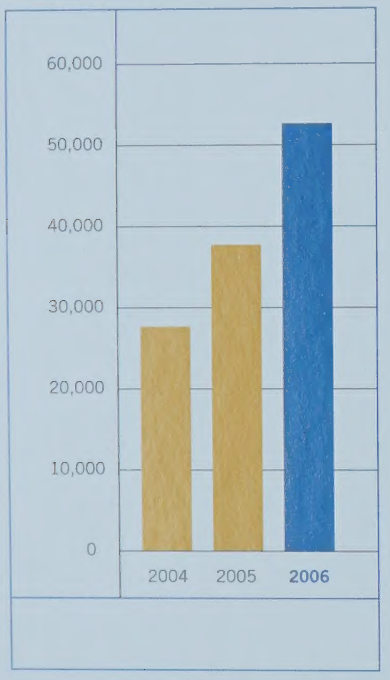
high speed/cable
– enables two people to videoconference with a low quality image and is dependant on the number of other users

dial-up
– enables two people to send a text-based message

financial highlights

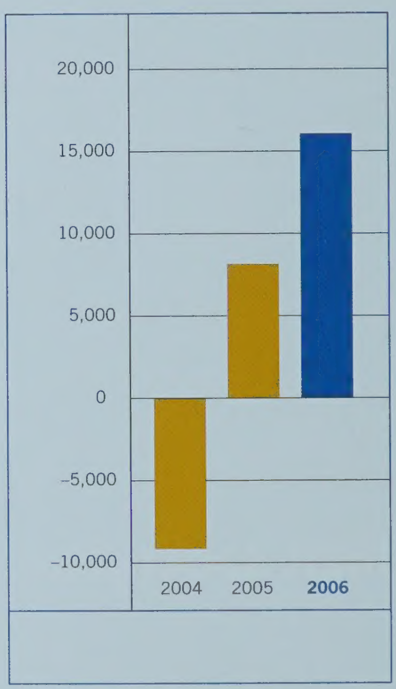
2006 was the best fiscal year in Axia's history.

consolidated revenue
(in $millions)



gross profit
(in $millions)

net income
(in $millions)



Notes:

- Based on historical financial results
- For a discussion as to future expectations, refer to Management's Discussion and Analysis included in the Annual Report

The table below outlines selected information for the years ended June 30, 2006, 2005 and 2004.

($000s except per share amounts)	2006 $	2005 $	2004 $
Revenue	**52,663**	37,732	27,677
Gross profit	**24,644**	17,284	3,380
Net income (loss) from continuing operations	**19,820**	9,950	(3,956)
Net income (loss)	**16,075**	8,150	(9,163)
Net income per share from continuing operations (loss) – basic	**0.37**	0.23	(0.09)
Net income per share from continuing operations (loss) – diluted	**0.35**	0.22	(0.09)
Net income per share (loss) – basic	**0.30**	0.19	(0.22)
Net income per share (loss) – diluted	**0.29**	0.18	(0.22)
Total assets	**50,113**	41,375	21,935
Total long-term financial liabilities	**1,923**	6,166	8,245

letter to shareholders

Dear Fellow Shareholders:

Axia's financial performance is now beginning to reflect the compelling value proposition that Axia's Open Access Real Broadband Services provide to our customers.

These Open Access Real Broadband Services are gaining growing recognition by progressive governments and businesses as basic infrastructure necessary for each to be globally competitive. Axia's value proposition has a breakthrough character, which means that while it is compelling in its widespread benefit, it represents a substantial change and therefore is not easy to adopt by those that are uncomfortable with change. Therefore, Axia's likelihood of winning these long-term customer relationships is not easy to forecast and they each typically have long lead times to develop.

From Axia's shareholders' point of view, Axia's success means attractive long-term positioning in quality long-term assets. These long-term assets have reliable revenues and a prospect for increased profitability based on the growing demand for both basic bandwidth and value-added services. These characteristics should, over time, attract premium quality earnings valuations from the public capital markets with the attendant benefit for Axia shareholders. One of your management's challenges is to do its part in achieving this treatment.

The combination of Axia's track record, our Open Access Real Broadband Services and our focus on this opportunity gives Axia a leadership position in this specialty market. Your management is organizing to seek out, prioritize and pursue on a disciplined basis opportunities that fit our service solutions. In this respect we have made substantial early progress in France where our joint venture with VINCI Networks has won 10 concessions and we are in the process of building Open Access Networks and offering Real Broadband Services. We look forward to reporting this progress during the next year.

Also, pushing the envelope, we are developing value-added services that we believe customers will find attractive once they have access to Real Broadband. These value-added services tend to also have a breakthrough character and have the attendant marketing and sales challenges. We believe that the prospects over the medium and longer term are attractive and lasting.

Your management will pursue these initiatives without compromising in any way our continuing drive to deliver truly superior customer service to our existing customers. For the next year, the combination of our management priorities will provide the opportunity to grow Axia's shareholder value.

team Axia

Subsequent to the end of our fiscal year, we announced that Geoff Thompson would succeed Murray Wallace as President of Axia. On behalf of the Board and your fellow shareholders, Murray deserves a special thank you, for his many critical contributions and his willingness to extend the term of his commitment to Axia to help us through the difficult years and also enabling a smooth transition of leadership.

Geoff has successfully developed and led three technology businesses and has excellent experience in successfully selling technology-based services in markets around the world. The Board welcomes Geoff to the Axia team. Together we will continue to develop the Axia team with the objective of aligning it to Axia's challenges and opportunities as they evolve.

On behalf of the Board of Directors and the Axia team, I would like to thank Stephen Wetmore for his involvement on the Axia Board of Directors during fiscal 2006. Recently, Stephen accepted a new challenge at Bell Aliant and thus, is not able to continue to serve on the Axia Board so he has decided to step down. We greatly benefited from his business acumen and experience.

Given Axia's current position in this evolving market, the performance of Axia's management this year should be judged on management's ability to deliver on these priorities while maintaining its quarterly earnings performance. I am confident that the Axia team continues to be up for this challenge.

Art Price, *Chairman and CEO*
September 5, 2006

Axia acts both as a technology integrator and market optimizer – we spearhead, design, plan, build and operate ultra-high-performance, real broadband open access networks that provide fragmented and under-served geographic regions access to IP connectivity.

We lead by example, having created the Alberta SuperNet, which we believe is the world's best IP regional broadband network. We are now exporting our solution to France and other regions around the world.

management's discussion and analysis

(All numbers in $000s unless otherwise noted)

The following Management's Discussion and Analysis ("MD&A") should be read in conjunction with: the audited consolidated financial statements for the years ended June 30, 2006 and 2005 as well as the related notes thereto and the Letter to Shareholders included at the beginning of this Annual Report. References to the years 2006 and 2005 are for the fiscal years ended June 30, 2006 and 2005 respectively. Axia's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada. All dollar amounts are in Canadian dollars.

Certain statements contained in the following MD&A and elsewhere in this Annual Report, including, without limitation, statements containing the words "believes", "anticipates", "estimates", "creates", "expects", and similar words or phrases constitute forward-looking statements. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties, which could cause actual results to differ materially from those anticipated in these forward-looking statements. These risks and uncertainties include, but are not limited to: changes in customer markets; changes in demand for the Corporation's services; trends in the development of the Internet as a commercial medium; success in marketing broadband networks in other jurisdictions; the inability of the Corporation to deliver services in a timely and cost-efficient manner; the ability of the Corporation to execute its business plans; technological changes; and general economic conditions.

We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law.

Additional information relating to Axia including its 2006 Annual Information Form can be found on SEDAR at www.sedar.com.

eliminating the digital divide – a global problem

Governments around the world are recognizing that the long-term economic impact of broadband is critical infrastructure for their economies and that IP-based connectivity will underpin their future economic prosperity, increase standards of living and the development of knowledge economies in both urban and rural communities. Much like how railways and roads were critical infrastructure in the previous century, broadband is widely recognized as the foundation for high-performing economies during this century.

Axia saw the limitations of the old copper legacy model and created a new way of approaching this problem using IP technologies. In the IP world, everything can be carried and delivered on a single powerful fibre optic network with state-of-the-art optic electronics. We created a business model and established a unique position for ourselves where traditional incumbents will not readily compete. To get to the global gateway, end users only need local access providers at the community level and an independent operator at the regional level, which is the niche that we fill.

Axia's unique open access network model – a breakthrough solution

Our business philosophy is built on the belief that all forms of communications that rely on powerful networks should not be limited to major urban centres as organizations, companies and individuals can benefit from high-quality, high-capacity, cost-effective connectivity wherever they live or work.

As an "operator of operators," we provide quality of service connectivity to all service providers, creating choice for the customer and levelling the playing field for both urban and rural customers in a geographic region. This innovative approach to network design and management – equal access to Real Broadband connectivity – challenges traditional telecommunications providers, who have focused on delivering network services to more densely populated areas where they have large, concentrated customer bases and more economic network costs. Non-metropolitan areas – especially in terms of the Internet and data connectivity – have lagged behind, limiting business potential and hampering rural and small-town citizens' access to educational, commercial and social service resources.

Axia's Open Access Network model delivers Real Broadband network services over large geographic areas and creates major opportunities for economic growth. Axia operates as an impartial, expert buyer and manager of network services on behalf of our customers, which ensures that competition results in the best service at the lowest cost for every end user. And because Axia charges a standard rate for bandwidth – with no volume discounts or price breaks for multi-point connectivity – new local network service providers can operate on an equal footing with larger existing providers.

the Alberta SuperNet – an Axia solution

The Alberta Government had a vision to make global connectivity available to all Albertans regardless of whether they lived in rural or urban areas. Thanks to an innovative solution by Axia, the Government of Alberta has a state-of-the-art IP network that connects 429 communities and provides direct connectivity to 4,400 government, learning, health, library and municipal locations.

More importantly, the Alberta SuperNet uses our Open Access Network model which creates a competitive environment for service providers who want to deliver ultra-high-speed services, including Internet access, to their retail and business customers – especially those who reside in rural areas. Thus, any service provider can buy Real Broadband directly from us, in our role as operator of the Alberta SuperNet.

To date, we have 74 local Internet service providers who have signed contracts with us to connect and use the Alberta SuperNet network. There are now 413 service connections into the SuperNet Points of Presence and 180 communities have access to high-speed Internet services. Currently 80 percent of Alberta residents have access to high-speed Internet options. Once service providers have a presence in all Alberta SuperNet communities, 95 percent of Alberta residents will have access to high-speed Internet. We believe this is an amazing accomplishment when, prior to the Alberta SuperNet, there were only seven service providers operating outside of Alberta's two largest metropolitan centres.

Axia's Alberta SuperNet business

We entered into a ten-year renewable licence with the Government of Alberta, which began on October 1, 2005, to operate the Alberta SuperNet and provide network-managed services to the government and industry. We believe that the potential size of our Alberta SuperNet opportunity over time could be in the range of $44 million to $60 million in revenues per year. Based on our existing long-term contracts, we expect our base level of revenues to be in excess of $9 million per quarter from which we anticipate operating profits normally in the 30 percent range.

As adoption of the Alberta SuperNet continues to grow, we can expect revenue increases from the additional traffic on the network. As part of our long-term contracts, we are committed to providing a base bandwidth capacity of approximately 40 gigabits. Axia profits through incremental sales over this base amount and we are currently providing about 30 gigabits of bandwidth usage. We estimate that the total revenue impact from increased bandwidth usage over the base amount could be in the range of $10–$15 million per year over time with operating profits of about 20 percent.

We intend to grow our Alberta SuperNet business not only by increasing bandwidth usage among our existing customers and signing up new customers, but also by developing and selling value-added services on the network. One such proposed service being developed is AxiaSecure Perimeter Protection ("AxiaSecure"), a scalable, flexible perimeter security solution that draws on our ongoing experience in protecting data on the Alberta SuperNet. AxiaSecure will be rolled out in the fall of 2006 and we are currently lining up beta customers to help us build out this business. We do not expect AxiaSecure to have a material impact on our financial results until fiscal 2008. Value-added services such as this could provide an additional revenue source that we expect could increase base revenues by up to $15 million annually with operating profits of about 25 percent beginning in the latter part of fiscal 2007.

From a growth perspective, the Alberta SuperNet provides us with an exceptional reference Real Broadband network and reinforces our unique position as a leader in the design and commissioning of ultra-high-performance networks, while demonstrating our ability to deliver world-class performance in the managed network services sector. Additionally, our continuing strategic relationships allow us to leverage our expertise into other markets both in Canada and abroad and enhances our competitive position going forward.

France – an Axia solution to removing the digital divide

France has consistently been among the most advanced economies in Europe in the use and development of telecommunications services. France has Europe's third largest telecom market, and a population recognized for its adoption of emerging technologies.

The Government of France believes that ubiquitous broadband Internet access is a critical national infrastructure and has implemented an "operator of operators" policy framework that supports building open and competitive IP networks. It has committed to spend €3 billion using an existing procurement process, which is now under way. This is the right policy framework for Axia's open access solution to succeed.

The development of IP networks in France is being pursued on a regional or community basis and in excess of 70 regions may undertake these network initiatives over time. These IP network concessions have a term of 15 to 20 years and represent a concession to sell wholesale IP services and/or dark fibre to local, regional, national and international operators.

We have been involved in France since October 2004 and have a strong French partner, VINCI Networks. During fiscal 2006, we announced that we had reached a memorandum of understanding with VINCI Networks to create a joint venture to pursue network concessions in France with each party bringing their respective concession interests to the joint venture. This transaction is expected to close by September 30, 2006.

As an "operator of operators", our joint venture in France will create competition which supports local access operators and Internet service providers as they deliver their IP services to administrative, business and retail customers. We anticipate that the development and operation of IP-based networks in France represents a significant business opportunity, which will unfold over the next several years.

Subsequent to year-end, we also announced that the proposed joint venture parties were successful in obtaining interests in two additional regional concessions in France. Once the transaction is completed, the joint venture will have interests in 10 concessions that have terms from 10 to 15 years and has an aggregate population of three million people, 1,500 communities and 100,000 businesses. In the past year, Axia, either through Axia France or the proposed joint venture, has submitted or prepared 13 concession bids. The timelines for decisions on each of these bids will be made in the next six to 12 months. We expect that over the following year we might respond to another 30 bids out of a possible 50 that could be put out to bid.

One important distinction between our Alberta SuperNet business and France is that we do not have a base level of long-term government business in France as we do in Alberta. In France, we pursue customers on an individual basis and do not provide services until the networks are built and operational. Accordingly, at the earliest, we do not expect our France business to have a material impact on ongoing operations until fiscal 2008.

activities in other jurisdictions

For a jurisdiction to be of interest to us, a government must first put in place the proper policy framework, as was the case in both Alberta and France. Currently, other areas of interest are Australia, North Africa, the Middle East and Singapore. However, although we have had discussions with representatives of these jurisdictions, all of these potential initiatives are at a very preliminary stage.

fiscal 2006 consolidated financial results

During fiscal 2006, we sold the NOW.net software applications business, which we had been conducting in both Canada and the United Kingdom. Accordingly, the operating results of this business unit have been classified as discontinued operations on our financial statements and prior period results have also been restated to reflect this business as discontinued operations.

The table below outlines selected information for the years ended June 30, 2006, 2005 and 2004.

($000s except per share amounts)	2006 $	2005 $	2004 $
Revenue	52,663	37,732	27,677
Gross profit	24,644	17,284	3,380
Net income from continuing operations	19,820	9,950	(3,956)
Net income (loss)	16,075	8,150	(9,163)
Net income per share from continuing operations (loss) – basic	0.47	0.23	(0.09)
Net income per share from continuing operations (loss) – diluted	0.35	0.22	(0.09)
Net income per share (loss) – basic	0.30	0.19	(0.22)
Net income per share (loss) – diluted	0.29	0.18	(0.22)
Total assets	50,113	41,375	21,935
Total long-term financial liabilities	1,923	6,166	8,245

consolidated quarterly comparison

The table below outlines quarterly results for the three-month periods ended June 30 and March 31, 2006 and December 31 and September 30, 2005.

$000s except per share amounts)	Q4 2006 $	Q3 2006 $	Q2 2006 $	Q1 2006 $
Revenue	12,100	11,519	13,603	15,441
Gross profit	5,232	5,782	5,888	7,742
Net income from continuing operations	4,772	4,803	4,474	5,771
Net income	4,772	3,032	3,059	5,212
Net income per share from continuing operations – basic	0.09	0.09	0.08	0.11
Net income per share from continuing operations – diluted	0.08	0.08	0.08	0.11
Net income per share – basic	0.09	0.06	0.06	0.10
Net income per share – diluted	0.08	0.05	0.05	0.10

The table below outlines quarterly results for the three-month periods ended June 30 and March 31, 2005 and December 31 and September 30, 2004.

($000s except per share amounts)	Q4 2005 $	Q3 2005 $	Q2 2005 $	Q1 2005 $
Revenue	17,047	9,727	6,208	4,750
Gross profit	8,345	5,457	2,743	740
Net income (loss) from continuing operations	[illegible]	3,942	1,289	(677)
Net income (loss)	[illegible]	3,732	921	(1,224)
Net income (loss) per share from continuing operations – basic	0.12	0.09	0.03	(0.02)
Net income (loss) per share from continuing operations – diluted	0.11	0.09	0.03	(0.02)
Net income (loss) per share – basic	0.11	0.09	0.02	(0.03)
Net income (loss) per share – diluted	0.10	0.08	0.02	(0.03)

revenues

Our consolidated revenues increased by 40 percent for the year ending June 30, 2006 to $52.7 million (2005: $37.7 million). Increased revenues are due to the final completion and commissioning of the Alberta SuperNet and the operations of the Alberta SuperNet. During fiscal 2006, revenues generated from long-term operating contracts totalled $36.4 million.

Consolidated revenues for the fourth quarter of fiscal 2006 were $12.1 million (2005: $17.0 million). This was due to the fourth quarter of 2005's revenues consisting mainly of revenues from the completion and commissioning phase of the Alberta SuperNet. Revenues generated from long-term operating contracts totalled approximately $10.2 million during the fourth quarter of fiscal 2006.

The Alberta SuperNet became operational on October 1, 2005 and, accordingly, our revenues and operating results since that time have been generated primarily from the provision of services over this network.

gross profit

Gross profit and the cost of products and services sold are as follows:
For the periods ended June 30, 2006 and 2005.

	Three Months				Twelve Months			
	2006		2005		2006		2005	
($000s)	$	%	$	%	$	%	$	%
Cost of products and services sold	[illegible]	[illegible]	8,702	51.0	[illegible]	[illegible]	20,448	54.2
Gross profit	[illegible]	[illegible]	8,345	49.0	[illegible]	46.8	17,284	45.8

The cost of operating the Alberta SuperNet comprises 86 percent of the total cost of products and services sold for the current quarter. We have now been operating the Alberta SuperNet for three consecutive quarters, and the total network operating costs incurred during this period was $16.6 million. These amounts include field operating costs for the network of $6.9 million since operations began in the second quarter of fiscal 2006. During the last quarter of the current year, scheduled and additional field maintenance services were being performed due to favourable weather conditions. Accordingly, Cost of Products and Services Sold

rose to 56.8 percent for the current quarter as compared to 49.8 percent for the third quarter of fiscal 2006. These additional services are scheduled to be completed by September 30, 2006.

In accordance with generally accepted accounting principles in Canada, maintenance costs are expensed as they are incurred. As the Alberta SuperNet network assets are new, we would assume that actual maintenance costs incurred to date may not be indicative of those, which could be experienced, in later years. Accordingly, we expect increased maintenance costs over the long term.

expenses

During the quarter ended June 30, 2006, total expenses were $2.3 million as compared to $2.9 million for the prior year. For the year ended June 30, 2006 expenses were $6.6 million (2005: $7.4 million). Expense categories are as follows with significant changes discussed thereafter:

For the periods ended June 30, 2006 and 2005.

	Three Months		Twelve Months	
($000s)	2006 $	2005 $	2006 $	2005 $
Marketing	415	239	1,320	725
Administration	675	1,423	1,300	2,044
Business development	572	384	1,589	1,034
Stock-based compensation	44	14	[illegible]	187
Interest and financing charges	(120)	175	(349)	1,115
Warrant financing charges	[illegible]	164	10	767
Depreciation and amortization	[illegible]	549	[illegible]	1,478
	[illegible]	2,948	[illegible]	7,350

marketing

Marketing expenses consist primarily of salaries, travel and office-related costs associated with selling and marketing Axia's products and services. Marketing costs increased 82 percent for the year ended June 30, 2006 as compared to the prior year. With the completion of the Alberta SuperNet during the second quarter, we are actively engaged in selling additional services on this network.

administration

Administration costs consist primarily of salaries, travel and office-related costs for the executive group as well as legal fees, public company costs and general corporate overhead. Administration costs were 36 percent lower for the year ended June 30, 2006. This was largely due to a recovery of office expenses in the amount of $0.6 million, which was booked in the third quarter of fiscal 2006, related to the subleasing of excess office space on favourable terms.

business development

Business development consists primarily of salaries, travel and office costs associated with the pursuit of new next-generation, IP assets on a global basis, and the development of new services to sell over these networks. Business development costs for fiscal 2006 were up 54 percent over the previous year as a result.

interest and financing charges

During the current year, we have been earning interest income on our short-term deposits and marketable interest-bearing securities. Net interest income for the year ended June 30, 2006 was $0.3 million compared to an expense of $1.1 million in the previous year. Interest expense and financing charges for the prior year were related to term debt and notes payable, all of which had been repaid by September 30, 2005.

depreciation and amortization

Depreciation and amortization for the year ended June 30, 2006 was up significantly to $2.7 million compared to $1.5 million in the prior year. This was primarily due to the purchase and deployment of revenue-generating technology assets used in the Alberta SuperNet during the current year. The majority of these technology assets have now been acquired and deployed.

Management depreciates equipment at rates consistent with their expected useful lives using straight-line methods ranging from 10 to 100 percent per annum. Technology and product development costs are amortized using the straight-line method over their estimated useful life, currently 33.3 percent per annum.

income taxes

To date, Axia has not paid any material cash income taxes. This is a result of the income tax pools and losses we historically accumulated before the Alberta SuperNet was constructed and became fully operational. Commencing in fiscal 2005, the Corporation began generating not only net income but also taxable income. Currently, we are reporting net income but do not pay any income taxes, as we can use these significant historical tax credits and losses to reduce our taxable income and offset any current cash tax liability. The potential ability to utilize these available tax pools and losses to offset future taxes payable is referred to as a "future income tax asset".

Compliance with Canadian generally accepted accounting principles concerning the recognition of future income tax assets requires that, at each balance sheet date, management consider the recognition of any potential future income tax assets. Considering this recognition process involves a significant amount of management judgment, the employment of estimates and a considerable analysis as to the ultimate determination of future probabilities, all or any of which, by their very nature, may or may not occur. In essence, the specific guidelines as to the recognition of future income tax assets requires management to forecast future probabilities and events on a basis of being "more likely than not" to occur. In the determination of all financial results, management attempts to view all judgments and estimates conservatively. In this instance, we have maintained this conservative approach, but revised our analysis to be consistent with the specific guidelines.

Accordingly, we have decided to recognize a portion of the future benefit of some non-capital losses and temporary tax differences as at June 30, 2006, which resulted in the recognition of $1.8 million of future income tax assets for the current fiscal year. At future balance sheet dates, we will revise our estimates in making a determination as to the recognition of any

potential future income tax assets. These new estimates, and management's judgment as to the likelihood of future probabilities, will take place after the Corporation has gained a longer history of operating results for the Alberta SuperNet, which is a very large geographic and complex IP-based network, gained additional experience with the operating, field, maintenance and repair costs of this network, and obtained more formative indications as to the rate of growth in bandwidth usage and the amount of sales of value-added services for the network. We will be in a better position at future balance sheet dates to forecast the amounts and rate of utilization of any future income tax assets that may exist at that time.

discontinued operations

During fiscal 2006, we completed the sale of our NOW.net software applications business, which we had been conducting in both Canada and the United Kingdom. The results of this business unit have been classified as discontinued operations on our financial statements and prior period results have also been restated to reflect this change. During the current year, the "Loss from Discontinued Operations" was $3.7 million, as compared to $1.8 million loss for the prior year. We do not anticipate any further material charges to discontinued operations from the disposal of this business unit.

In fiscal 2005, we sold our Interactive Media Services operations located in Edmonton and our partnership interest in the AdFarm marketing and communications business, which was also a component of Interactive Media Services. The financial results of these operations have also been presented as discontinued operations.

net income

For the three-month period ended June 30, 2006, income from continuing operations decreased to $4.8 million or $0.08 per common share on a fully diluted basis (2005: $5.4 million or $0.11 per common share). For the year ended June 30, 2006 income from continuing operations increased to $19.8 million or $0.35 per common share on a fully diluted basis (2005: $10.0 million or $0.22 per common share).

During the fourth quarter of fiscal 2006, Axia recognized $1.8 million of future income tax assets (2005: nil), which increased net income from continuing operations for both the current quarter and our year-end results.

For the fourth quarter of fiscal 2006, consolidated net income was $4.8 million or $0.08 per common share on a fully diluted basis (2005: $4.7 million or $0.10 per common share). Consolidated net income for the year ended June 30, 2006 was $16.1 million or $0.29 per common share on a fully diluted basis (2005: $8.2 million or $0.18 per common share).

goodwill and deferred costs

Management reviews the appropriateness of the carrying value of goodwill on an annual basis, and more frequently if events or changes in circumstances indicate that an impairment loss may have been incurred. The Corporation performs a projected cash flow analysis, based on a review of historical and projected results. These projected cash flows are then used to estimate the fair value of the Corporation. A goodwill impairment loss is recognized when the carrying amount of the goodwill exceeds its fair value. Management also considers whether a long-term impairment in the value of the business has occurred. Based on these assessments, an impairment of goodwill may occur. In both 2006 and 2005, no impairment loss to the value of goodwill was recorded.

The balance for technology and product development costs as of June 30, 2006 was $0.7 million (2005: $0.1 million). Technology and product development costs comprise the software, programming and content development costs for software

applications that have been developed and are being marketed and sold. These costs are amortized on a straight-line basis once an application has been completed and released for sale.

We regularly review the capitalized development costs for all software applications, whereby the unamortized balance of these costs is compared to the projected cash flows for the applications, and a determination is made as to whether the carrying value should be reduced. Many variables and estimates are considered during this process, including estimates as to future market potential, consumer acceptance, application prices and expected margins, product economic life, the availability of management and capital resources and technological obsolescence, among others. In both 2006 and 2005, Axia did not record any additional write-downs related to the software applications available as at June 30, 2006.

liquidity and capital resources

At the end of fiscal 2006, Axia had working capital of $26.5 million compared to working capital of $0.7 million at the end of fiscal 2005. Working capital has increased substantially this fiscal year due to profitable operations and the issuance of common share equity. As of June 30, 2006, we had approximately $28.4 million cash and short-term investments available for general corporate purposes.

During the fourth quarter of fiscal 2006, we prepaid in full the long-term bank equipment loan of $4.4 million. The Corporation has no outstanding bank debt as at June 30, 2006.

We regularly review our level of capital resources, and adjust our capital spending plans accordingly. This review includes discretionary capital requirements and potential sources of related capital. The evaluation takes into account factors such as the current economic environment, the state of equity markets, the ability to complete equity financings on favourable terms and the availability and prudence of debt financing.

contractual obligations

($000s)	Total $	Less than 1 year $	1–3 years $	4–5 years $	After 5 years $
Operating and premise leases	11,486	2,043	3,695	1,944	3,804
Capital leases	881	275	606	0	0
Total contractual obligations	12,367	2,318	4,301	1,944	3,804

commitments

As at the end of fiscal 2006, our main capital commitment consisted of our agreement to fund Axia's 50 percent interest in a joint venture to be created with VINCI Networks regarding our expanding operations in France. This commitment totals approximately $9.0 million cash and we expect to fund these amounts to the joint venture during fiscal 2007.

Subsequent to year-end, the Corporation also announced that the joint venture was successful in obtaining two additional regional network concessions in France. The construction and deployment of these networks will involve an additional capital contribution by the Corporation to the joint venture of approximately $9.3 million. It is anticipated that these funds would be required during fiscal 2007 and 2008.

These future joint venture funding commitments total approximately $18.3 million. The Corporation currently has cash resources in excess of these funding requirements.

share capital

As at June 30, 2006 and also the date hereof, we had 54.5 million (2005: 46.8 million) common shares outstanding. Subsequent to the end of fiscal 2005, Bell Canada subscribed for 5 million common shares in the capital of the Corporation at a price of $2.00 per common share. During fiscal 2006, an additional 2.8 million common shares were issued due to the exercise of existing stock options and warrants.

As of June 30, 2006, we had 0.6 million employee stock options and 2.6 million warrants outstanding. The warrants, which were earned as part of a debt financing during fiscal 2004, are exercisable at $0.60 per share and expire in December 2006. Assuming all outstanding options and warrants were exercised, we would have 57.7 million common shares fully diluted outstanding.

trends, commitments, events, risks and uncertainties

We operate in competitive and evolving markets locally, nationally and globally. These markets are subject to rapid technological change and changes in customer preferences and demand. The telecommunications, technology and managed services sectors involve business risks that could significantly impact the operating results, financial condition and future development plans of Axia. Markets for our products and services are often unproven and undeveloped, highly competitive, and subject to rapid technological change. Axia faces price competition, the challenge of developing new markets, and creating market awareness for many of these products and services.

We compete for a substantial portion of our revenues on a competitive bid basis. There is no certainty that we will be successful in obtaining future bids, or that successful bids will prove to be profitable. In addition, there is no certainty that the new products and services being developed by us will meet long-term customer acceptance. The product life cycle of these products and services can be short and subject to rapid technological change.

A significant portion of our business activities are related to the Alberta SuperNet network pursuant to contracts with the Government of Alberta and Bell Canada, as well as the operation thereof pursuant to a licence agreement with the Government of Alberta. In the event there is a failure to perform these contracts by any party, or if the contracts were put into dispute for any reason, the current and future business operations of Axia would be affected.

Our solutions often depend on Axia contracting elements of the solution from third parties. There is a risk these third parties will not perform their obligations or Axia may incur expenses and delays while it enforces its contractual rights.

We counter these and other business risks with our ability to attract and retain professional and well-trained managers, marketers, technical staff and other employees. There can, however, be no assurance that Axia will be successful in attracting new employees or motivating key personnel. We continue to attract, retain and motivate personnel by creating a dynamic working environment and by rewarding employees with a comprehensive remuneration package that may include stock options, benefits, performance-based remuneration and the ability to purchase common shares through the Axia Employee Share Purchase Plan.

accounting policies and critical accounting estimates

The consolidated financial statements of the Corporation have been prepared by management in accordance with Canadian generally accepted accounting principles for annual financial information and using the same accounting policies and methods of computation as the audited consolidated financial statements for the fiscal year ended June 30, 2006, except as disclosed in the Notes to the Consolidated Financial Statements.

Certain of these accounting policies are recognized as critical because, in applying these policies, management is required to make judgments, assumptions and estimates that have a significant impact on the financial results of the Corporation. Areas which involve a significant amount of judgment and employ many estimates and assumptions include the determination of the carrying value of assets such as goodwill and technology and product development costs, the useful life and applicable depreciation and amortization policies for property and equipment, the recognition of future income tax assets and the assessment of potential contingencies, among others. Actual results could differ materially from these estimates and assumptions as additional information becomes available in the future.

outlook

Going forward, we remain focused on our three priorities: growing bandwidth sales on the Alberta SuperNet to increase its profit contribution; developing and marketing value-added services to leverage our IP networking capabilities to meet our customers' needs; and generating additional long-term revenues from new next-generation IP assets in France and other jurisdictions.

disclosure controls and procedures

Management, including the Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by the annual filings and has concluded that the disclosure controls are effective in ensuring that all material information required to be filed has been made known to them in a timely fashion. The required information was effectively recorded, processed, summarized and reported within the time period necessary to prepare the annual filings. The disclosure controls and procedures are effective in ensuring that information required to be disclosed pursuant to applicable securities laws are accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

management's report to shareholders

The accompanying consolidated financial statements of Axia NetMedia Corporation have been prepared by management in accordance with Canadian generally accepted accounting principles.

The Corporation's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable. Management is satisfied that these financial statements have been prepared accordingly and within reasonable limits of materiality. Further, management is satisfied that the financial information throughout the balance of this report is consistent with the information presented in the financial statements.

The Audit Committee, consisting of independent directors, has reviewed these statements with management and the auditors and has reported the results of this review to the Board of Directors. The Board of Directors has approved the financial statements.

Geoff Thompson, *President*
September 5, 2006

Peter L. McKeown, *CA, Chief Financial Officer*

auditors' report to shareholders

We have audited the consolidated balance sheets of Axia NetMedia Corporation as at June 30, 2006 and 2005, and the consolidated statements of operations and retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Company's Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Calgary, Canada
September 5, 2006

consolidated balance sheets

($000s)	June 30, 2006 $	June 30, 2005 $
Assets		
Current assets:		
Cash	16,706	5,917
Restricted cash	162	12,837
Short-term investments	12,435	–
Accounts receivable	3,224	1,338
Other receivable	–	3,660
Prepaid expenses	1,511	183
Future income tax *(note 10)*	1,100	–
Current assets of discontinued operations *(note 13)*	–	445
	35,138	24,380
Restricted cash	–	1,777
Technology and product development costs *(note 3)*	651	121
Property and equipment *(note 4)*	9,114	8,916
Goodwill	4,201	4,201
Other assets *(note 5)*	1,009	1,361
Assets of discontinued operations *(note 13)*	–	619
	50,113	41,375
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	6,900	4,587
Deferred revenue	1,280	12,372
Current portion of lease obligation *(note 6)*	235	233
Current portion of note payable *(note 7)*	–	4,000
Current portion of bank loan *(note 8)*	–	971
Cost of excess space *(note 17)*	97	385
Current liabilities of discontinued operations *(note 13)*	92	1,126
	8,604	23,674
Deferred revenue	1,045	682
Lease obligation *(note 6)*	630	890
Bank loan *(note 8)*	–	3,882
Cost of excess space *(note 17)*	248	712
Shareholders' equity: *(note 9)*		
Share capital	23,981	11,658
Warrants	449	704
Contributed surplus	260	352
Retained earnings (deficit)	14,896	(1,179)
	39,586	11,535
Significant contracts, economic dependence and credit risk *(note 15)*		
Contingencies, commitments and guarantees *(note 16)*		
Subsequent event *(note 18)*	50,113	41,375

See accompanying notes to the consolidated financial statements.

On behalf of the board:

C. Kent Jespersen Art Price

consolidated statement of operations & retained earnings (deficit)

For the years ended June 30, 2006 and 2005

($000s except per share amounts)	2006 $	2005 $
Revenue	52,663	37,732
Cost of products and services sold	28,019	20,448
Gross profit	24,644	17,284
Expenses:		
Marketing	1,320	725
Administration	1,300	2,044
Business development	1,589	1,034
Stock-based compensation	60	187
Interest and finance charges	(349)	1,115
Warrant financing charges	10	767
Depreciation and amortization	2,694	1,478
	6,624	7,350
Income before income tax recovery *(note 10)*:	18,020	9,934
Future income tax recovery	1,800	–
Income tax recovery	–	16
Income from continuing operations:	19,820	9,950
Loss from discontinued operations *(note 13)*	(3,745)	(1,800)
Net income	16,075	8,150
Deficit, beginning of year	(1,179)	(9,163)
Adjustment to reflect change in accounting policy	–	(166)
Retained earnings (deficit), end of year	14,896	(1,179)
Net income per share from continuing operations:		
Basic	0.37	0.23
Diluted	0.35	0.22
Net income per share:		
Basic	0.30	0.19
Diluted	0.29	0.18
Weighted average shares outstanding:		
Basic	53,837	42,725
Diluted	56,079	45,095

See accompanying notes to the consolidated financial statements.

consolidated statements of cash flows

For the years ended June 30, 2006 and 2005

($000s)	2006 $	2005 $
Cash provided by (used in):		
Operating activities:		
Income from continuing operations	19,820	9,950
Items not involving cash:		
Depreciation and amortization	2,694	1,478
Warrant financing charges	10	767
Other assets	352	7
Cost (recovery) of excess space	(752)	12
Stock-based compensation	60	187
Other	54	–
Funds provided by continuing operations	22,238	12,401
Changes in non-cash working capital items:		
Accounts receivable	(1,886)	1,177
Other receivable	3,660	(3,660)
Prepaid expenses	(1,328)	(136)
Future income tax recovery	(1,800)	–
Accounts payable and accrued liabilities	1,867	341
Deferred revenue	(10,729)	12,144
	12,022	22,267
Cash used in discontinued operations *(note 13)*	(3,482)	(357)
	8,540	21,910
Financing activities:		
Issue of common shares for cash	11,916	2,956
Proceeds (repayment) of lease obligation	(248)	1,123
Repayment of note payable	(4,000)	–
Repayment of term debt	–	(8,024)
Proceeds (repayment) of bank loan	(5,398)	4,853
	2,270	908
Investing activities:		
Short-term investments	(12,489)	–
Decrease (increase) in restricted cash	14,452	(14,614)
Cash provided by (used in) discontinued operations related to investing activities *(note 13)*	(233)	2,181
Purchase of property and equipment	(1,697)	(6,441)
Technology and product development costs	(754)	(47)
	(721)	(18,921)
Change in cash	10,089	3,897
Cash, beginning of period	5,917	2,020
Cash, end of period	16,006	5,917

See accompanying notes to the consolidated financial statements.

notes to the consolidated financial statements

For the years ended June 30, 2006 and 2005 (tabular amounts in thousands of dollars, except per share amounts)

1. description of business

Axia NetMedia Corporation (the "Corporation") creates and manages technology-rich service solutions for our customers that enable organizations to have information that is necessary for high-performance, real-time decision-making. Axia calls these managed services "NetMedia Services".

2. significant accounting policies

a **consolidation:** These consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiary.

b **revenue recognition:** Revenue from fixed price and long-term construction contracts is recorded on a percentage of completion basis. Estimated earnings are accrued based upon the costs incurred to date as a percentage of total estimated costs to complete the project. Projected losses are provided in full as soon as they become apparent. Revisions in estimated costs and earnings during the course of work are reflected during the accounting period in which the data that determines such revisions becomes known. Revenue generated from subscriptions is recognized over the term of the related subscription. Revenue from network operations is recognized as the services are provided. Disbursement and fee income are recognized at the time the work is performed and collection is determined to be reasonably assured. Revenue includes both fees and recoverable expenses. Rental income derived from premise subleases is recognized as revenue over the term of the sublease.

c **short-term investments:** These consist of bonds, certificates of deposit and shares of mutual funds which are all readily marketable and may be liquidated upon short notice. These short-term investments are valued at the lower of cost and market value. The market value of these investments as at June 30, 2006 was $12,434,665.

d **technology and product development costs:** Research costs are expensed as incurred. Development costs of new interactive application systems are capitalized if they meet generally accepted accounting criteria for deferral. Amortization is determined using the straight-line method over their estimated economic life. The value of development costs is reviewed when events or changes in circumstances indicate the carrying value may be impaired. Where there is considered to be an impairment in the estimated net recoverable amount of these costs, based upon expected future cash flows, the costs are written down to their estimated recoverable value. Amortization of technology and product development costs during the year was $223,788 (2005: $323,283).

e **property and equipment:** Property and equipment are recorded at cost. Depreciation is recorded on property and equipment at rates consistent with their expected useful lives using straight-line methods ranging from 10 percent to 100 percent. Depreciation expense during the year was $2,470,621 (2005: $1,154,275).

f **goodwill:** Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on their fair values. Goodwill is allocated as of the date of the business combination to the Company's reporting units that are expected to benefit from the synergies of the business combination. Goodwill is not amortized but is tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying value amount of a reporting unit exceeds its fair value, in which case the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss. The impairment loss is recognized in an amount equal to the excess and is presented as a separate line item in the statement of operations before extraordinary items and discontinued operations. No impairment loss was recorded for 2006 and 2005.

g **investments:** Investments in companies where the Corporation retains a minor ownership position and does not exert significant influence thereon are recorded using the cost basis of accounting. These investments are included in Other Assets.

h **leases:** Leases are classified as capital or operating based upon the terms and conditions of the contracts.

i **foreign currency translation:** The Corporation uses the temporal method of foreign currency translation to translate the accounts of its foreign subsidiary, which are considered financially and operationally integrated. Transactions in foreign currencies are translated at the rate in effect at the time of the transaction. Resulting unrealized gains or losses are charged to earnings. Foreign exchange income during the year which is included in interest and financing charges is $9,299 (2005: $(15,382)).

j **income taxes:** The Corporation uses the liability method of accounting for income taxes, whereby future income tax liabilities and future income tax assets are recorded based on temporary differences being the difference between the carrying amount of an asset and liability in the consolidated balance sheet and its underlying tax basis.

k **stock-based compensation plans:** For stock options issued to employees and directors, compensation expense related to those awards is recognized based on the fair value of the options on the date of the grant that is determined by using an option-pricing model. The fair value of the options expected to vest is recognized over the vesting period of the options granted as compensation expense and contributed surplus. The Corporation adjusted the opening retained earnings and contributed surplus for fiscal 2005 by $166,000. This adjustment was required when the Corporation adopted the fair value compensation method in accordance with generally accepted accounting principles.

l **excess space:** The Corporation regularly reviews its lease commitments to ensure that they provide an economic benefit over the term of the lease. The cost of excess space is recorded in the period when it is determined that no economic benefit exists by expensing the future lease cost less any estimated recovery through sublease arrangements.

m **per share amounts:** These are calculated using the weighted average number of shares outstanding for the year. Diluted earnings per share is calculated using the treasury stock method to determine the dilutionary impact of warrants and options outstanding.

n **use of estimates and measurement uncertainty:** The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the applicable period. The Corporation operates in a highly competitive and technology driven environment. The consumer software and telecommunications industry is undergoing substantial change and is subject to a high level of uncertainty. The Corporation's operations include developing and marketing Internet-based network solutions and software systems for new and evolving markets. Accordingly, management's determination as to the recoverability of costs deferred in relation to these operations includes a forecasting process based on estimates of future events, which are often made with limited information. The Corporation has estimated the recoverability of goodwill and technology and product development costs based upon rapidly changing industry trends, an intense competitive environment, changing technology trends and anticipated economic factors. Should the Corporation's business environment, conditions or business change, it may result in an impairment of these assets and may in turn result in an adjustment of the future carrying values by a material amount. Other areas requiring use of estimates include expenses to be charged under construction and operating contracts, amortization and depreciation periods for assets, cost of excess space, future income tax assets and potential contingencies. Actual results could differ from management's best estimates and underlying assumptions, as additional information becomes available in the future.

o **comparative figures:** Certain comparative figures have been reclassified to conform with the financial statement presentation for the current year.

3. technology and product development costs

	Cost $	Accumulated amortization $	Net book value $
June 30, 2006	1,727	1,076	651
June 30, 2005	973	852	121

4. property and equipment

June 30, 2006	Cost $	Accumulated amortization $	Net book value $
Technology hardware	9,497	2,595	6,902
Computer software	448	122	326
Furniture and fixtures	408	337	71
Leasehold improvements	3,066	1,251	1,815
	13,419	4,305	9,114

June 30, 2005	Cost $	Accumulated amortization $	Net book value $
Technology hardware	7,673	697	6,976
Computer software	45	10	35
Furniture and fixtures	406	168	238
Leasehold improvements	2,636	969	1,667
	10,760	1,844	8,916

Included in the amounts reported is technology hardware financed under capital lease obligations (note 6) with a cost of $1.1 million (2005: $1.1 million) and accumulated amortization of $230,000 (2005: $163,000).

5. other assets

	2006 $	2005 $
Deferred costs	373	585
Deposits	142	405
Investments	494	371
	1,009	1,361

6. lease obligation

During fiscal 2005, the Corporation entered into a capital lease to purchase technology assets to be used on the Alberta Super-Net. The capital lease is repayable over a five-year period with an interest rate of approximately seven percent. Pursuant to this lease, the Corporation sold $855,000 of technology equipment to the lessor during September 2004. The resulting book gain of $172,000 is being recognized over the term of the lease.

The estimated future minimum payments due on capital lease obligations are as follows:

	$
2007	275
2008	271
2009	265
2010	70
	881
Less amounts representing interest	(108)
Unamortized portion of gain on sale of assets under capital lease	112
	885
Less current portion	(255)
	630

7. note payable

At June 30, 2005, the Corporation had drawn $4.0 million on a note payable facility which bore interest at 8 percent per annum and was due on October 3, 2005. During the current year, the Corporation repaid this facility in full without penalty.

8. bank loan

At June 30, 2006, the Corporation had established a $3.0 million revolving line of credit facility with its primary lender. This facility bears interest at bank prime plus 0.5 percent per annum which is payable monthly. The security for this facility includes the assets of the Corporation and corporate guarantees. No amounts have been drawn on this facility.

During 2006, the Corporation repaid in full the amount drawn on an $8.0 million long-term equipment loan facility which bore interest at bank prime plus 1.5 percent per annum. As at June 30, 2005, the outstanding amount of the loan was included in both current and long-term liabilities in amounts representing the scheduled maturity thereof.

9. share capital

a **authorized:** Unlimited number of common shares

Unlimited number of first and second preferred shares, issuable in series.

b **common shares issued:**

	June 30, 2006		June 30, 2005	
	Number #	Amount $	Number #	Amount $
Balance, beginning of year	46,765	11,658	42,055	7,939
Issued for cash:				
Exercise of options	1,298	1,137	110	195
Exercise of warrants	1,483	1,144	4,600	3,523
Private placement	5,000	9,890	–	–
Transfer from contributed surplus on exercise of options		152	–	1
	54,546	23,981	46,765	11,658

c **warrants:**

	June 30, 2006 Number #	June 30, 2005 Number #	Exercise price per share $	Date of Expiry
Short-term loan	2,569	2,589	0.60	December 22, 2006
Term debt	–	1,463	0.60	Varying to July 30, 2005
	2,569	4,052		

(i) In conjunction with a short-term loan, the Corporation issued 2,625,000 warrants in December 2003. A fair value of $459,000 ascribed to these warrants has been included within shareholders' equity and was offset against the associated term loan of $3.5 million. In March 2004 the term loan was repaid in full.

(ii) In conjunction with an $8.0 million term debt, the Corporation issued 6,026,250 warrants. Upon grant of the warrants, the fair value ascribed to these warrants of $1.0 million was included within shareholders' equity and offset against the associated term debt. The term debt was repaid in full during fiscal 2005.

d **stock options:**

(i) The Corporation may grant stock options to directors, officers and employees. At June 30, 2006 there were 611,666 (2005: 2,065,000) stock options outstanding to acquire Common Shares at prices ranging from $0.50 to $2.75 per share, with expiry dates ranging from October 2006 to April 2011. The following table sets forth a reconciliation of stock options granted, exercised and cancelled during the years ended June 30, 2006 and June 30, 2005:

	2006 Shares #	2006 Weighted-average exercise price $	2005 Shares #	2005 Weighted-average exercise price $
Outstanding, beginning of year	2,065,000	1.18	1,200,000	1.83
Granted	30,000	2.75	1,225,000	0.63
Exercised	[illegible]	[illegible]	(110,000)	1.60
Cancelled	[illegible]	[illegible]	(250,000)	1.48
Outstanding, end of year	611,666	[illegible]	2,065,000	1.18
Exercisable	388,337	0.54	736,662	2.21

(ii) During the year ended June 30, 2006, the Corporation granted 30,000 (2005: 1,225,000) employee stock options. The fair value of stock options granted is estimated on the date of grant using an option pricing model with the following weighted average assumptions used for options granted in fiscal 2006: weighted-average volatility of 34 percent; risk-free interest rate of 4 percent; and the expected life of the option of five years. During the year, the Corporation recorded $59,641 (2005: $187,258) as compensation expense related to these employee stock options. The weighted average fair value of options granted during the year was $2.75 per option.

(iii) The following table sets forth information relating to stock options outstanding at June 30, 2006.

Range of exercise prices	Number outstanding at June 30, 2006 #	Weighted-average remaining contractual life $	Weighted-average exercise price $
$0.50 – $2.75	611,666	2.68	0.96

(iv) The following table sets forth information relating to stock options outstanding at June 30, 2005.

Range of exercise prices	Number outstanding at June 30, 2005 #	Weighted-average remaining contractual life $	Weighted-average exercise price $
$0.50 – $5.00	1,965,000	3.16	1.02
$5.01 – $5.60	100,000	0.33	5.60
	2,065,000	2.92	1.24

e **contributed surplus:**

The Corporation records compensation expense using the fair value method. Fair values are determined using an option pricing model. Compensation costs are recognized over the vesting period as an increase to stock-based compensation expense and contributed surplus. When options are subsequently exercised, the fair value of such options in contributed surplus is credited to share capital. During the year, contributed surplus changed as follows:

	2006 $	2005 $
Contributed surplus, beginning of year	352	–
Retroactive adoption of fair value method *(note 2(l))*	[illegible]	166
	[illegible]	166
Stock-based compensation expense	[illegible]	187
Stock options exercised	(152)	(1)
Balance, end of year	260	352

10. income taxes

a The income tax provision differs from the amount which would result from applying the expected income tax rate to net income from continuing operations before income taxes. The differences between the computed "expected" income tax provision and the actual income tax provision are summarized as follows:

	2006 $	2005 $
Net income before tax from continuing operations	18,020	9,934
Expected income tax rate	42.3%	33.9%
Computed "expected" income tax expense	6,820	3,368
Difference resulting from:		
Non-deductible expenses	[illegible]	851
Change in valuation allowance	(7,661)	(3,962)
Non-taxable portion of capital gains	[illegible]	(273)
Future income tax recovery	(1,800)	(16)

b The components of the Corporation's future income tax assets at June 30, 2006 and 2005, of which $1,800,000 have been recorded in these financial statements, are as follows:

	2006 $	2005 $
Non-capital losses	477	9,257
Capital losses	1,533	429
Research and development tax pools	232	244
Capital assets	7,873	7,420
Other	329	209
	10,444	17,559
Less valuation allowance	(8,644)	(17,559)
Future income tax assets	1,800	–

The Corporation has non-capital loss carryforwards of approximately $1,484,000 (2005: $28,757,000) which have been reflected above and begin to expire in 2014. A summary of the non-capital loss carryforwards by year of expiry is as follows:

Year of expiry	$
2014	917
2015	567
	1,484

11. supplemental cash flow information

	2006 $	2005 $
Interest paid	427	954
Taxes	5	19
Interest received	(751)	(117)

12. operating lease commitments

Future minimum payments under operating leases for the following five years are as follows:

	$
2007	2,317
2008	1,614
2009	1,412
2010	1,216
2011	1,142

13. discontinued operations

During fiscal 2006, the Corporation sold the NOW.net software applications business. The results of this business in both Canada and the United Kingdom have been reported as discontinued operations. Management determined that in difficult market conditions, these Interactive Media products and services did not achieve a sufficient level of sales and accordingly decided to sell these operations. This business was sold on March 31, 2006 for nominal proceeds to a former manager of this business. The buyer agreed to provide ongoing hosting and product maintenance services to the existing NOW.net client base which represented a future contractual obligation of the Corporation. These services are to be provided until April 30, 2007 and the remaining estimated cost totalling $814,253 has been expensed at June 30, 2006 as a loss from discontinued operations.

(i) The results of these discontinued operations are as follows:

($000s)	2006 $	2005 $
Revenue	934	12,552
Cost of products and services sold	1,059	9,464
Gross profit	(125)	3,088
Expenses		
Marketing	1,839	1,879
Administration	827	2,519
Interest	44	113
Depreciation and amortization	852	342
	3,562	4,853
Loss before income tax expense	(3,687)	(1,765)
Income tax expense (recovery)	58	35
Loss from discontinued operations	(3,745)	(1,800)
Net loss per share		
Basic	(0.07)	(0.04)
Diluted	(0.07)	(0.04)
Weighted average shares outstanding		
Basic	53,837	42,725
Diluted	56,079	45,095

(ii) The assets and liabilities presented in the consolidated balance sheets include the following assets and liabilities of discontinued operations:

($000s)	June 30, 2006 $	June 30, 2005 $
Current assets	–	445
Long-term assets	–	619
Current liabilities	[illegible]	1,126

(iii) The cash flows from discontinued operations are as follows:

For the years ended June 30

($000s)	2006 $	2005 $
Cash provided by (used in):		
Operating activities		
Net loss from discontinued operations	(3,745)	(1,800)
Items not involving cash:		
Depreciation and amortization	852	342
Cash used in discontinued operations	(2,893)	(1,458)
Changes in non-cash working capital items:		
Accounts receivable	350	2,030
Prepaid expenses	90	23
Inventory and work in progress	24	536
Accounts payable and accrued liabilities	(493)	(2,315)
Deferred revenue	(541)	(754)
	(5,547)	(1,938)
Increase in cash	65	1,581
Cash provided by (used in) discontinued operations	(5,482)	(357)
Investing activities:		
Disposal (purchase) of property and equipment	53	(95)
Technology and product development costs	(286)	(583)
Changes in non-cash items:		
Disposal of goodwill	–	2,433
Other assets	–	426
Cash provided by (used in) discontinued operations related to investing activities	(233)	2,181
	(5,715)	1,824

14. financial instruments

Fair value of financial instruments: The carrying amount of the Corporation's financial assets and liabilities at June 30, 2006 and 2005 approximated their fair value due to their short term to maturity.

15. significant contracts, economic dependence and credit risk

On September 21, 2004, the Corporation settled all remaining outstanding issues with Bell Canada. These issues related to the construction and operation of the Alberta SuperNet. An arbitration decision in September 2004 resolved the operational issues. The settlement resolves the remaining issues without arbitration. As part of the settlement, the Corporation agreed to provide advisory and other services to Bell Canada from the effective date until June 30, 2005.

During the third quarter of fiscal 2005, the Corporation also entered into additional agreements with Bell Canada with respect to the completion and the commissioning of the Alberta SuperNet project. These contracts became effective on January 1, 2005 with completion thereof on September 30, 2005. Pursuant to the terms of these contracts, Bell Canada advanced funds for project completion. Some of these advances were to be used solely for approved work on the project and any unexpended portion thereof may be refunded under certain conditions. As at June 30, 2006, $0.2 million (2005: $12.8 million) of these advances, which are also included in deferred revenue as a current liability, have been shown as restricted cash.

Effective October 1, 2005, the Corporation also entered into revised contracts with the Government of Alberta and Bell Canada with respect to the operation of the Alberta SuperNet for an initial period of ten years.

Substantially all of the revenues reported by the Corporation for the years ended June 30, 2006 and 2005 relate to the performance of services under these Alberta SuperNet contracts. If these contracts were put into dispute for any reason, or if the Corporation's role in this project was terminated, the realization of assets relating to these contracts and the Corporation's ongoing operating results, may be adversely affected.

16. contingencies, commitments and guarantees

The Corporation may periodically be subject to litigation and claims from customers, suppliers, former employees and other third parties. The Corporation will defend itself against these claims pursuant to legal means, and may also register counterclaims and seek damages from the plaintiffs. Due to the nature and status of these claims, it is not possible to determine the timing, amount or outcome of any potential judgments. However, management does not believe that any such judgments will have a material adverse impact on the financial position of the Corporation.

During the course of business, the Corporation enters into a number of commitments related to its operations on the Alberta SuperNet and in France. In general, these commitments relate to the Corporation's ability to design and construct networks to certain standards and maintain minimum service levels on these networks. Under the terms of the licence and related agreements to operate the Alberta SuperNet, the Corporation is committed to certain operating expenditures and also to provide certain standards of customer service and performance. To maintain these standards, the Corporation is required to maintain, or replace where appropriate, certain assets owned by others. The Corporation has issued a $1.5 million letter of credit to a third party pursuant to the terms of a significant contract. The letter of credit may be drawn by the holder in the event of a major default in the contract. The amount and timing of any expected draws on the letter of credit are not determinable.

The Corporation has entered into a memorandum of understanding to form a new French joint venture company with its partner in which the Corporation will hold a 50 percent interest. As part of this agreement, the Corporation will advance approximately $9.0 million to the new French company. It is anticipated that this transaction will close and the funds will be advanced during fiscal 2007.

Subsequent to the end of fiscal 2006, the Corporation also announced that the proposed French joint venture was successful in obtaining two additional regional network concessions in France. The construction and deployment of these networks will involve an additional capital commitment by the Corporation of approximately $9.3 million. It is anticipated that these funds will be advanced during fiscal 2007 and 2008.

17. cost of excess space

During the year ended June 30, 2006, the Corporation was successful in subleasing excess space on favourable terms, which resulted in a reduction in the cost of excess space of $638,222, which was recognized in the current year as a reduction in administration expense.

18. subsequent event

Subsequent to the year ended June 30, 2006, the Corporation announced that it had entered into binding agreements to implement the French joint venture.

corporate directors

Art Price (Chairman)
C. Kent Jespersen
Robert L. Phillips
John Read
Stephen Wetmore

management team

Art Price – Chief Executive Officer
Geoff Thompson – President
Peter McKeown – Chief Financial Officer
Jim Lindberg – Controller
Dawn Tinling – Vice-President, Investor Relations and Communications
Drew McNaughton – Directeur Général, Axia France and Chief Technology Officer
Katrina Ashmore – Vice-President, Global Marketing
Lisa Shackelton – Vice-President, Sales and Customer Relationship Management
Dave Ehman – Vice-President, Operations
Dan Chervenka – Acting Director, Information Technology

William Smith, Q.C. – Corporate Secretary

transfer agent

Computershare Trust Company of Canada
Calgary, Alberta

bankers

ATB Financial
Calgary, Alberta

lawyers

McCarthy Tétrault LLP
Calgary, Alberta

auditors

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stock exchange listing

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annual meeting

Tuesday, November 7, 2006
3:00 p.m. (Mountain)
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100 6th Ave. SW,
Calgary, Alberta

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